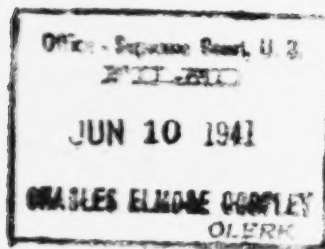


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No. 151

In the Supreme Court of the United States

OCTOBER TERM, 1941

UNITED STATES OF AMERICA, PETITIONER

v.

JOLIET & CHICAGO RAILROAD COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH
CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit, entered in the above cause on March 10, 1941, reversing the decision of the District Court of the United States for the Northern District of Illinois.

OPINIONS BELOW

The District Court filed no opinion. The opinions of the Circuit Court of Appeals (R. 48-55) are reported at 118 F. (2d) 174.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 10, 1941 (R. 55). The jurisdiction of this Court is invoked under Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Respondent leased its railroad and equipment in perpetuity in consideration of an agreement by the lessee company to pay specified annual dividends to respondent's stockholders and to pay any federal income taxes imposed upon respondent because of the dividend payments. The question is whether the dividend and tax payments made by the lessee constitute income to the respondent.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutes and regulations are set forth in the Appendix, *infra*, pp. 9-10.

STATEMENT

The facts, as stipulated (R. 30-35) and as found by the District Court (R. 35-40), may be summarized as follows:

On January 1, 1864, the respondent, an Illinois corporation (R. 36), then the owner of some 37 miles of railroad tracks between Joliet and Chicago, Illinois, and of appurtenant equipment, entered into a contract, called a Lease Agreement (R. 9-18), with the Chicago and Alton Railroad Company. Pursuant to the terms of this Lease Agreement, respondent "demised and leased" its tracks and equipment to the Chicago and Alton Railroad Company in perpetuity (R. 36). In return, the Chicago and Alton Railroad

Company agreed to guarantee and pay to the respondent's stockholders forever, in quarterly installments, an annual dividend of seven per centum upon the par value of respondent's outstanding stock (R. 36). In addition the Chicago and Alton agreed to pay any federal taxes imposed upon respondent by virtue of the payment of the dividends (R. 13).

Respondent's stock issue is limited to 15,000 shares, of a par value of \$100 per share (R. 36-37). Each stock certificate contains on its face a provision setting forth the guarantee obligation of the Chicago and Alton (R. 36-37). The annual dividend which the Chicago and Alton and its successor, the Alton Railroad Company, is required to pay is \$7 per share or a total of \$105,000 (R. 37). This amount has been paid to respondent's stockholders every year since 1864, including the years 1931 to 1934, inclusive (R. 37). In addition, the Alton Railroad Company paid federal income taxes for respondent in the amount of approximately \$14,000 for the year 1931 and of approximately \$16,000 for each of the years 1932 to 1934 (R. 38-39).

Respondent filed claims for refund for the income taxes paid on its behalf for the years 1931 to 1934, asserting that it had received no income in those years and that no income taxes were due from it (R. 39). Upon rejection of the claims, two actions were instituted in the District Court (R. 2, 19), where they were consolidated (R. 30).

The District Court entered judgment in favor of the United States (R. 41), but the court below reversed (R. 55), one judge dissenting (R. 53-55).

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the dividend payments made in the years 1931 to 1934 by the lessee to the respondent's stockholders and the income taxes paid during those years by the lessee for the respondent did not constitute income to the respondent.

2. In reversing the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

The consistent course of decision in the circuit courts of appeals has been that where a corporate taxpayer makes a long-term lease of all of its property to another company in consideration for the payment by the lessee of stipulated dividends to the taxpayer's stockholders, the taxpayer realizes taxable income in the amount of the dividends paid. *Gold & Stock Telegraph Co. v. Commissioner*, 83 F. (2d) 465 (C. C. A. 2d), certiorari denied, 299 U. S. 564; *United States v. Northwestern Telegraph Co.*, 83 F. (2d) 468 (C. C. A. 2d); *Harwood v. Eaton*, 68 F. (2d) 12 (C. C. A. 2d); *American Telegraph & Cable Co. v. United States*, 61 C. Cls. 326, certiorari denied, 271 U. S. 660; *Blalock v. Georgia Ry. & Electric Co.*, 246 Fed. 387 (C. C. A. 5th); *Rensselaer*

& *S. R. Co. v. Irwin*, 249 Fed. 726 (C. C. A. 2d), certiorari denied, 246 U. S. 671; *Northern R. Co. of New Jersey v. Lowe*, 250 Fed. 856 (C. C. A. 2d); *West End St. Ry. Co. v. Malley*, 246 Fed. 625 (C. C. A. 1st), certiorari denied, 246 U. S. 671.¹ The decision in the present case is, in principle, in conflict with all of these other decisions.

The majority of the court below sought to distinguish the cases cited on the ground that they involved leases with a specified term—in one case 99 years, in another 500 years, and in a third 999 years—rather than, as here, a lease in perpetuity. The court pointed out that a lease for a specified term, however lengthy, does not transfer title to the property from the lessor to the lessee, while a lease in perpetuity, without a defeasance clause, acts as an outright conveyance. This factual distinction between the present case and the long term lease cases, above cited, was considered sufficient to justify a difference in result.

In our view, however, the distinction is one without substance. Assuming that the lease constituted a conveyance of title, the only effect is to make the payments in question payments of purchase price, or payments in the nature of ground rent, rather than payments of ordinary rental. Even if regarded as purchase price or ground rent, how-

¹ The last four cases were all cited with approval by this Court in *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716 and in *United States v. Boston & M. R. Co.*, 279 U. S. 732.

ever, the payments are as much income as though they were ordinary rent, since there was no proof offered, or contention made, that they did not represent a profit.

Since it is clear that the payments constituted income, the only issue is whether respondent realized that income. And on that issue it is plainly immaterial whether the payments were made for the use and occupancy of, or for the conveyance of title to, the property. In each of the long-term lease cases cited above, the taxpayer was held to have realized income by way of constructive receipt because the payments to its stockholders were in discharge of an obligation owing to the taxpayer by the lessee and were thus made on the taxpayer's behalf. By the same reasoning, the respondent here realized income because the payments to its stockholders were in discharge of an obligation owing to it by the lessee and were thus made on its behalf. The fact that in one case the obligation arises out of a lessor-lessee relationship, and in the other out of a vendor-vendee relationship, is without tax significance.

In the present case, as in the other cases cited, the taxpayer's stockholders received payments from the lessee only because of their status as stockholders of the respondent. Any individual who ceased to be a holder of respondent's stock ceased receiving the payments from the lessee. It is apparent, therefore, that whether or not title

to the property passed, respondent must be treated "as a link in the income receiving chain" (*Gold & Stock Telegraph Co. v. Commissioner, supra*, at 467) and, as such, must be held subject to taxation on all payments made in its behalf. This Court has frequently affirmed that property or money does not have to pass physically through the hands of the taxpayer in order to subject him to the tax burdens incident to ownership of the income. *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716; *United States v. Boston & M. R. Co.*, 279 U. S. 732. Cf. *Raybestos-Manhattan, Inc. v. United States*, 296 U. S. 60.

Resolution of the conflict between the present case and the cases involving long-term leases for a specified period is of considerable practical importance. There are now pending in the Bureau of Internal Revenue several cases similar to the present one in which the lease agreements are in perpetuity. Sizable sums are involved in these cases and, since the obligation to make the payments is a continuing one, the problem will recur each year. Moreover, the decision below may induce the modification of existing long-term leases into leases in perpetuity. Such modification would not substantially affect the rights of the lessor or lessee companies *inter sese*, and yet might, under the decision below, entirely relieve the lessor corporation of liability for the income tax.

CONCLUSION

It is respectfully submitted that the petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,
Solicitor General.

JUNE 1941.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

Similar provisions will be found in Section 22 of the Revenue Act of 1932, c. 209, 47 Stat. 169; and in Section 22 of the Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C., Title 26, Sec. 22).

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 70. *Income to lessor corporation from leased property.*—Where a corporation has leased its property in consideration that the lessee shall pay in lieu of other rental an amount equivalent to a certain rate of dividend on the lessor's capital stock or the interest on the lessor's outstanding indebtedness, together with taxes, insurance, or other fixed charges, such payments shall be considered rental payments and shall be

returned by the lessor corporation as income, notwithstanding the fact that the dividends and interest are paid by the lessee directly to the shareholders and bondholders of the lessor. The fact that a corporation has conveyed or let its property and has parted with its management and control, or has ceased to engage in the business for which it was originally organized, will not relieve it from liability to the tax. While the payments made by the lessee directly to the bondholders or shareholders of the lessor are rentals as to both the lessee and lessor (rentals paid in one case and rentals received in the other), to the bondholders and the shareholders such amounts are interest and dividend payments received as from the lessor and as such shall be accounted for in their returns.

Similar provisions will be found in Article 70 of Treasury Regulations 77, promulgated under the Revenue Act of 1932; and in Article 22 (a)-20 of Regulations 86, promulgated under the Revenue Act of 1934.

